

INTRODUCTION

Statutory Authority

The General Assembly enacted P.L. 37-1996, which requires that the prudent investor standard shall apply to all Indiana public retirement funds. In doing so, the General Assembly noted the following:

Whereas, the general assembly also believes that a prudent diversification of investments by public retirement funds is an essential element of a stringent investment standard for such funds and is critical for the future; and

Whereas, the general assembly finds that numerous actuarial studies of retirement funds in Indiana and other states have demonstrated that, due to the long term nature of the investment made by public retirement funds, diversification of such investments in a responsible manner reduces risk, increases income, and improves security for such funds, while a lack of diversification results in reduced income and increased risk to the retirement funds, while creating a substantial additional burden for the taxpayers who ultimately bear the burden of providing the assets for such funds in the absence of sufficient income; and

Whereas, the general assembly desires to pass a diversification rule patterned after the stringent federal law applicable to private plans, which will provide that the trustees of each fund must diversify the investments of their fund so as to minimize the risk of large losses.

Although the General Assembly desired to subject all of Indiana's public retirement plans to these standards, P.L. 37-1996 did not specifically amend the statutes governing the operation and administration of the Indiana State Police pre-1987 benefit system and the Indiana State Police 1987 benefit system ("Systems").

On May 12, 1997, P.L. 39-1997 was enacted. The Bill provided a new chapter to the Indiana Code, specifically, IC 5-10-0.5. In Section

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1 of the chapter, the General Assembly outlines that both the Indiana State Police pre-1987 benefit system (IC 10-1-2.2) and the Indiana State Police benefit system (IC 10-2-2.3) are not subject to the prohibitions of Article XI, Section 12 of the Constitution of the State of Indiana. Additionally, IC 5-10-0.5-1(b)(3) states the investments of the Indiana State Police benefit systems are subject to IC 10-1-2-2.

Finally, on May 13, 1997, P.L. 40-1997 was enacted. This public law amended IC 10-1-2-2(c) and establishes the prudent investor standard as the primary statutory provision governing the investment of the Fund's assets. IC 10-1-2-2(c) reads as follows:

The trust fund may not be commingled with any other funds and shall be invested only in accordance with Indiana laws for the investment of trust funds, together with such other investments as are specifically designated in the pension trust. Subject to the terms of the pension trust, the Trustee, with the approval of the Department and the Pension Advisory Board, may establish investment guidelines and limits on all types of investments (including, but not limited to, stocks and bonds) and take other action necessary to fulfill its duty as a fiduciary for the trust fund. However, the Trustee shall invest the trust fund assets with the same care, skill, prudence, and diligence, that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character with like aims. The Trustee shall also diversify such investments in accordance with prudent investment standards. The investment of trust funds is subject to section 2.5 of this chapter.

Other pertinent investment requirements in the Indiana Code include the following:

1. The pension trust shall satisfy the qualification requirements in Section 401 of the Internal Revenue Code, as applicable to the pension trust. In addition, the fund is a trust, exempt from taxation under Section 501 of the Internal Revenue Code. IC 10-1-2-2.5

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2. No part of the corpus or income of the pension trust may be used or diverted to any purpose other than the exclusive benefit of the participants and their beneficiaries. IC 10-1-2-2.5(b)(2).
3. The Trustee shall receive and hold as Trustee for the uses and the purposes set forth in the pension trust any and all funds paid by the department, the employee beneficiaries, or by any other person or persons. IC 10-1-2-2(d).
4. The Trustee may not engage in a transaction prohibited by Section 503(b) of the Internal Revenue Code. IC 10-1-2-2.5(b)(9).

A legal opinion dated January 28, 1998, by Ice Miller Donadio & Ryan, the System's general counsel, analyzes the System's authority to make investments under the Indiana Constitution and concludes that with the enactment of P.L. 39-1997, the System has the authority to invest its assets without regard to the prohibitions of Article XI, Section 12 of the Indiana Constitution. Additionally, it states that the statutory "prudent expert" rule will guide the establishment of portfolio limitations on the types and amounts of allowable investments. Thus, investment vehicles that would pass scrutiny under the prudent investor standards would be permissible investments.

INVESTMENT MANAGER GUIDELINES

General Guidelines

As fiduciaries of the Fund, all investment managers (regardless of type of investment) will discharge their duties solely in the interests of the Fund's members and beneficiaries and with the care, skill, prudence, and diligence that an expert would use on his/her own behalf. In addition, the investment managers shall observe the following rules:

- **Specific Limitation on Holdings.** The purchase of securities in any one nongovernmental corporation shall be limited to an initial cost of 5% of the market value of an investment manager's Portfolio. Through capital appreciation, no such holding should exceed 7.5% of the market value of the total holdings of such investment manager's Portfolio.
- **Securities Trading.** Each investment manager is to send copies of each transaction record to the Fund and its custodian(s), as requested. The investment manager is further required to reconcile the account(s) under its management on a timely basis each month with the custodian(s). Each investment manager is responsible for complying fully with the Fund's policies for securities trading and selecting brokerage firms.
- **Acknowledgments in Writing.** Each investment manager retained by the Fund must be a person, firm, or corporation registered as an investment adviser under the Investment Advisors Act of 1940; a bank as defined in such Act; or an insurance company qualified to do business in more than one state, and must acknowledge its fiduciary responsibility in writing. SEC registered firms will be expected to provide a copy of the SEC ADV Form Section II on an annual basis. All investment managers shall acknowledge in writing their receipt of this IPS and their agreement to abide by its contents. All investment managers shall have an affirmative duty to bring suggestions for modification or change to the Trustee, Department, and Board.

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- **Fiduciary Liability Insurance.** Each investment manager will obtain fiduciary insurance coverage in an amount not less than the assets under their management as required by the Trustee, Department, and Board. Each investment manager shall annually provide written evidence of such coverage.
- **Fidelity Bond.** Each investment manager will obtain fidelity bonds, in such amount as required by the Trustee, Department and Board. Each investment manager shall annually be required to provide written evidence of such coverage.
- **Proxy Voting.** Each investment manager will abide by the Fund's Proxy Voting Policy as stated in the Proxy Voting Policy Section of this IPS. Each investment manager will provide an annual report of proxy voting activity to the Fund consistent with the requirements of the Proxy Voting Policy Section.
- **Conflicts of Interest.** An investment manager shall be subject to the applicable provisions of the Code of Ethics Section of this IPS. An investment manager through its actions on behalf of the Fund shall not invest any part of the Fund with itself or with any person or entity with which or in which it has any economic interest, unless such investment manager receives prior written approval from the Trustee, Department, and Board. This limitation shall be construed so as to avoid any possibility of self-dealing or conflict of interest. In addition, no investment manager, through its actions on behalf of the Fund, shall act or receive compensation as a broker, dealer, underwriter, or principal whether directly or through a related or an affiliated entity, unless such investment manager receives prior written approval from the Trustee, Department, and Board.
- **Prohibited Securities and Transactions.** Unless the Trustee, Department, and Board gives its prior written approval, the following prohibited transactions and restrictions are in effect for investment managers:

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- Short sales of any kind
- Purchases of letter or restricted stock and other unregistered securities
- Purchases of futures and options
- Any transaction that would be a "prohibited transaction" under the Internal Revenue Code
- Purchases of precious metals
- Purchases of commodities or commodities contracts
- Margin purchases or sales, or any other form of leverage is prohibited
- Purchases of derivative securities except for collateralized mortgage obligations (CMOs).

- **Correction of Violations.** In the event a violation of the guidelines occurs, unless otherwise approved by the Trustee, Department, and Board in writing, based upon a determination of the best interests of the Fund, the violation:
 - Shall be corrected immediately by sale no later than the day following detection and notification; and
 - Shall result in the reimbursement of the Fund by the investment manager for any losses, fees and expenses which may have been incurred due to the violation; and
 - Shall result in the Fund retaining any gains which are realized from the violation; and
 - May be grounds for termination by the Trustee, Department, and Board

Securities Guidelines

Each separate account investment manager selected to manage Fund assets must adhere to the following guidelines as well as any applicable Indiana statutory requirements. Subject to the guidelines in this section of the IPS, each separate account investment manager shall have full discretionary investment authority over the assets each is responsible for managing. Each investment manager shall be retained to implement a specific investment style and strategy for the Fund. The strategy and underlying philosophy will be described in an addendum to each investment manager's contract. In addition, if the

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Trustee, Department and Board choose to invest a portion of the Fund in mutual funds or other commingled investment vehicles the products selected shall adhere to the guidelines set forth in the prospectus or trust document.

Large Capitalization Equity Investment managers

- Equity holdings in any one company should not exceed 5% of market value of the investment manager's portion of the Fund's portfolio at the time of purchase without the consent of the Trustee, Department, and Board. Bonds of the companies in question would be included in the company exposure calculation if held in the investment manager's portfolio.
- The main focus of investing for large capitalization equity investment managers will be on companies with a market cap in excess of \$8.0 billion at the time of purchase.
- Equity holdings in any one industry should not exceed 25% of the market value of the investment manager's portion of the Fund's portfolio. Equity holdings in any one sector (e.g. energy, technology, etc.) should not exceed 35% of the investment manager's portfolio market value.
- Purchasing on margin or any other form of leverage is prohibited.
- Investment managers shall have the responsibility for voting proxy issues on securities held. All proxies shall be voted exclusively for the best interests of the Fund and its participants. Investment managers will keep a proper record of all proxies to which the Fund is entitled, including a brief description of the reason for each.
- Each investment manager shall attempt to minimize uninvested cash balances. All investment managers will be evaluated against their peers on the performance of the total funds under their direct management.

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Passive Large Capitalization Equity Investment managers

The Trustee, Department and Board have chosen to invest a portion of the equity allocation in passive index funds, some of which may be enhanced. Any index fund investment manager is expected to adhere to the relevant guidelines as outlined in its trust document or prospectus.